

BOARD OF EQUALIZATION
STATE OF CALIFORNIA

In the Matter of the Appeal of:) **FORMAL OPINION**
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) **2005-SBE-001**
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 ALAN F. AND RITA K. SHUGART) Case No. 221743
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Representing the Parties:

For Appellant: Christopher A. Whitney, CPA

For Respondent: Jozel Brunett, Tax Counsel IV

Counsel for the Board of Equalization Ian C. Foster, Tax Counsel

This appeal is made pursuant to Section 19104 of the Revenue and Taxation Code from respondent's denial of appellants' request for a refund of interest accrued and paid on the 1988 and 1990 through 1994 tax years.¹ At issue is whether respondent abused its discretion in refusing to refund the requested interest.

Appellant-husband was the founder, chairman, and CEO of Seagate Technology. Appellant-wife is a businesswoman who runs the R.K. Shugart Clothing Store and is involved in other ventures. During the relevant years, appellants were the sole owners of Monterey Airplane Company (MAC), an S corporation that operates an aircraft charter service in Monterey, California. Pebble Beach Ventures (PBV) is a general partnership that operated several businesses including the R.K. Shugart Clothing Store (RKS). PBV's activities also included buying, selling, and holding real property in the partnership name, making numerous loans both to related and unrelated parties, investing in a variety of "start up" companies, and conducting separate horse-related and retail activities.

Appeal of Alan F. and Rita K. Shugart

1 During the years at issue in this appeal, the combined total of appellants' reported income
2 from Seagate Technology exceeded \$28 million. A large portion of that income, however, was offset on
3 appellants' returns by losses from RKS, MAC, and horse breeding/showing activities. Respondent
4 audited appellants' 1988 and 1990 through 1994 returns on the following issues: (1) the shareholders'
5 basis in MAC stock and debt; (2) whether RKS was an activity engaged in for profit or, on the other
6 hand, a nondeductible "hobby loss" activity; and (3) the claimed capital losses from PBV stock
7 transactions.

8 The substance of the underlying audit issues no longer concern us. Rather, in this appeal,
9 we must determine whether appellants are entitled to interest abatement due to alleged errors that caused
10 the audit and protest to be unreasonably long. The audit and protest lasted nearly nine years,
11 commencing with the first notice of an audit on August 26, 1992, and ending with the issuance of
12 Notices of Action (NOA's) on June 7, 2001. Appellants did not appeal the NOA's. Instead, appellants
13 paid the additional tax and interest and filed a request for a refund of paid interest. Respondent's denial
14 of that request resulted in this appeal.

15 Appellants contend that respondent is to blame for the unreasonable length of time it took
16 to complete the audit and protest process. They have provided a detailed accounting of alleged errors
17 and delays that caused the unnecessary accrual of interest and they have asked for a total of 42 and ½
18 months of interest abatement.

19 Respondent has agreed to abate nine months of interest due to an unreasonable delay in
20 scheduling the protest hearing. Otherwise, respondent contends that interest abatement is not
21 appropriate because the alleged errors and delays were either justifiable or not within the scope of the
22 interest abatement statute.

23 The assessment of interest on a tax deficiency is mandatory. (Rev. & Tax. Code,
24 § 19101, subd. (a); *Appeal of Amy M. Yamachi*, 77-SBE-095, June 22, 1976.) Interest is not a penalty
25 but simply compensation to the state for the lost time-value of money received after the due date.
26 (*Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) This being the case, there is no reasonable
27 cause exception to the imposition of interest. Nevertheless, section 19104, subdivision (a)(1), as in
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¹ All references to "section" or "sections" are to sections of the Revenue and Taxation Code, unless otherwise indicated.
Appeal of Alan F. and Rita K. Shugart

1 effect for the years at issue, gives respondent the authority to abate interest to the extent that any such
2 interest is attributable to an error or delay by an employee of respondent in the performance of a
3 ministerial act.

4 When respondent denies a request for a refund of paid interest under section 19104, the
5 taxpayer has the right to appeal to this Board within 90 days of the denial. (Rev. & Tax. Code, § 19104,
6 subd. (b)(2)(A)(ii).) This Board has the authority to overturn respondent's failure to abate interest if we
7 find an "abuse of discretion." (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).)

8 In previous cases brought before this Board, we have addressed the definitions of
9 "ministerial act" and "abuse of discretion," as well as the effect of various changes to section 19104 over
10 the years. The case at hand requires no further insight into those issues and, thus, none is offered.
11 Rather, this opinion is intended to provide some guidance to respondent who, at the oral hearing,
12 expressed sympathy for situations where the audit and protest are unreasonably long, but also asserted
13 that its hands are tied under its interpretation of the applicable law. This case presents that type of
14 sympathetic situation (no one has argued that nine years is a reasonable length of time to process a case
15 of this type) and the only question is whether, and to what extent, appellants may obtain relief from
16 interest.

17 After careful examination of the record, we are satisfied that respondent's employees
18 committed many errors and delays during the course of the audit and protest that caused the unnecessary
19 accrual of interest. However, because the errors and delays were numerous and successive, it is difficult
20 to identify the discrete periods that are attributable to individual errors and, therefore, subject to interest
21 abatement under section 19104. Moreover, we cannot determine how each individual error or delay
22 affected subsequent events; there may have been residual consequences of early errors that, compounded
23 by later events, magnified the total delay appellants experienced. In our opinion, under circumstances
24 such as these, it is the cumulative effect of the errors and delays that controls the period for which
25 interest will be abated. Here, the cumulative effect of the errors and delays was an unreasonably long
26 period for an audit and protest to last. Therefore, rather than trying to identify discrete periods
27 attributable to individual events, we conclude that interest abatement is warranted for the entire 42 and
28 ½ month period sought by appellants (which includes the nine months already conceded by respondent).

Appeal of Alan F. and Rita K. Shugart

1 We caution that this opinion is not intended to be a vehicle for relief from large amounts
2 of interest whenever respondent commits two or more errors over the life of an audit and protest. We
3 recognize, and do not wish to obstruct, California's right to be compensated for the lost time-value of
4 unpaid funds. Hence, in future cases, we will consider the cumulative effect of multiple errors and
5 delays only when they are chronic, repetitive, and occur in close proximity. Moreover, the nature of the
6 errors and delays must be such that one cannot readily identify the starting and ending points of discrete
7 periods attributable to individual errors and delays, nor determine the effect each individual error or
8 delay may have had on subsequent events. If those conditions are satisfied (they were in this case), we
9 will look at the cumulative effect of all errors and delays and, if that cumulative effect is determined to
10 be an unreasonably long delay in processing the case, we will order interest abatement.

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12 For the foregoing reasons, and to the extent described above, respondent's refusal to
13 refund interest is reversed.

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ORDER

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19104 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Alan F. and Rita K. Shugart for a refund of 42 and ½ months of accrued and paid interest for the years 1988 and 1990 through 1994 be and the same is hereby reversed.

Done at Sacramento, California, this 1st day of July 2005, by the State Board of Equalization, with Board Members Mr. Chiang, Ms. Yee*, Mr. Leonard, Mr. Parrish and Ms. Mandel** present. Mr. Parrish abstained.

John Chiang_____, Chairman

Betty T. Yee*_____, Member

Bill Leonard_____, Member

_____, Member

_____, Member

*Acting Member, First District

**For Steve Westly per Government code section 7.9

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Appeal of Alan F. and Rita K. Shugart